

OPERATING AGREEMENT

Between

STATE OF CALIFORNIA
DEPARTMENT OF WATER RESOURCES

And

PACIFIC GAS AND ELECTRIC COMPANY

THIS AGREEMENT HAS BEEN FILED WITH AND APPROVED BY THE CALIFORNIA PUBLIC UTILITIES COMMISSION ("COMMISSION") FOR USE BETWEEN THE STATE OF CALIFORNIA DEPARTMENT OF WATER RESOURCES ("DWR") AND PACIFIC GAS AND ELECTRIC COMPANY ("UTILITY").

Execution Date: December __, 2002

Date of Commission Approval: _____

Effective Date: _____

OPERATING AGREEMENT

This **OPERATING AGREEMENT** (this “Agreement”) is between the State of California Department of Water Resources (“DWR”), acting solely under the authority and powers granted by AB1X, codified as Sections 80000 through 80270 of the Water Code, and not under its powers and responsibilities with respect to the State Water Resources Development System, and Pacific Gas and Electric Company, a California corporation (“Utility”). DWR and Utility are sometimes collectively referred to herein as the “Parties” and individually referred to as a “Party.” Unless otherwise noted, all capitalized terms shall have the meanings set forth in Article I of this Agreement.

R E C I T A L S

WHEREAS, under the Act, DWR has entered into a number of long-term power purchase agreements for the purpose of providing the net short requirements to the retail ratepayers of the State's electrical corporations, including Utility; and

WHEREAS, the Contract Allocation Order of the Commission provides that such long-term power purchase agreements are to be operationally allocated among the State's electrical corporations, including Utility, solely for the purpose of causing the State's electrical corporations to perform certain specified functions on behalf of DWR, as DWR's limited agent, including dispatching, scheduling, billing and settlements functions, and to sell surplus energy, all as such functions relate to those certain power purchase agreements that are operationally allocated to each electrical corporation under the Contract Allocation Order; and

WHEREAS, DWR wishes to provide for the performance of such functions under the Allocated Contracts by Utility on behalf of DWR in accordance with such long-term power purchase agreements as provided in this Agreement; and

WHEREAS, consistent with the Contract Allocation Order, DWR will retain legal and financial obligations, together with ongoing responsibility for any other functions not explicitly provided in this Agreement to be performed by Utility, with respect to each of the Allocated Contracts and it is the intent of DWR and the Utility that the provisions of this Agreement will not constitute an “assignment” of the Allocated Contracts or Interim Contracts to Utility.

WHEREAS, consistent with the Interim Contract Order of the Commission, DWR expects to enter into certain Interim Contracts prior to January 1, 2003 and DWR wishes to provide for the administration of such Interim Contracts by Utility.

NOW, THEREFORE, in consideration of the mutual obligations of the Parties, the Parties agree as follows:

ARTICLE I DEFINITIONS

Section 1.01. Definitions. The following terms shall have the respective meanings in this Agreement:

The following terms, when used herein (and in the attachments hereto) with initial capitalization, shall have the meaning specified in this Section 1.01. Certain additional terms are defined in the attachments hereto. The singular shall include the plural and the masculine shall include the feminine and neuter, and *vice versa*. “Includes” or “including” shall mean “including without limitation.” References to a section or attachment shall mean a section or attachment of this Agreement, as the case may be, unless the context requires otherwise, and reference to a given agreement or instrument shall be a reference to that agreement or instrument as modified, amended, supplemented or restated through the date as of which such reference is made (except as otherwise specifically provided herein). Unless the context otherwise requires, references to Applicable Laws or Applicable Tariffs shall be deemed references to such laws or tariffs as they may be amended, replaced or restated from time to time. References to the time of day shall be deemed references to such time as measured by prevailing Pacific time.

“Act” means Chapter 4 of Statutes of 2001 (Assembly Bill 1 of the First 2001-02 Extraordinary Session) of the State of California, as amended.

“Agreement” means this Operating Agreement, together with all attached Schedules, Exhibits and Attachments, as such may be amended from time to time as evidenced by a written amendment executed by the Parties.

“Allocated Contracts” means the long-term power purchase agreements operationally allocated to Utility under the Contract Allocation Order, without legal and financial assignment of such agreements to Utility, as provided in Schedule 1 attached hereto.

“Allocated Power” means all power and energy, including the use of such power or energy as ancillary services, delivered or to be delivered under the Contracts.

“Applicable Commission Orders” means such rules, regulations, decisions, opinions or orders as the Commission may lawfully issue or promulgate from time to time, which relate to the subject matter of this Agreement.

“Applicable Law” means the Act, Applicable Commission Orders and any other applicable statute, constitutional provision, rule, regulation, ordinance, order, decision or code of a Governmental Authority.

“Applicable Tariffs” means Utility’s tariffs, including all rules, rates, schedules and preliminary statements, governing electric energy service to Utility’s customers in its

service territory, as filed with and approved by the Commission and, if applicable, the Federal Energy Regulatory Commission.

“Assign(s)” shall have the meaning set forth in Section 14.01.

“Bonds” shall have the meaning set forth in the Rate Agreement.

“Bond Charges” shall have the meaning set forth in the Rate Agreement.

“Business Day” means the regular Monday through Friday weekdays which are customary working days, excluding holidays, as established by Applicable Tariffs.

“Commission” means the California Public Utilities Commission.

“Confidential Information” shall have the meaning set forth in Section 11.01(c).

“Contracts” means the Allocated Contracts and the Interim Contracts.

“Contract Allocation Order” means Decision 02-09-053 of the Commission, issued on September 19, 2002, as such Decision may be modified, revised, amended, supplemented or superseded from time to time by the Commission.

“DWR Power” shall have the same meaning set forth in the Servicing Arrangement with such amendments to incorporate the Settlement Principles for Remittances and Surplus Revenues as provided in Exhibit C of this Agreement.

“DWR Revenues” means those amounts required to be remitted to DWR by Utility in accordance with this Agreement and as further provided in the Servicing Arrangement.

“Effective Date” means the effective date in accordance with Section 14.13, as such date is set forth on the cover page hereof.

“Fund” means the Department of Water Resources Electric Power Fund established by Section 80200 of the California Water Code.

“Good Utility Practice” means any of the practices, methods and acts engaged in or approved by a significant portion of the electric utility industry during the relevant time period, or any of the practices, methods and acts which, in the exercise of reasonable judgment in light of the facts known at the time the decision was made, could have been expected to accomplish the desired result at a reasonable cost consistent with good business practices, reliability, safety and expedition. Good Utility Practice does not require the optimum practice, method, or act to the exclusion of all others, but rather is intended to include acceptable practices, methods, or acts generally accepted in the Western Electric Coordinating Council region.

“Governmental Authority” means any nation or government, any state or other political subdivision thereof, and any entity exercising executive, legislative, judicial, regulatory or administrative functions of or pertaining to a government, including the Commission.

“Governmental Program” means any program or directive established by Applicable Law which directly or indirectly affects the rights or obligations of the Parties under this Agreement or which obligates or authorizes DWR to make payments or give credits to customers or other third parties under such programs or directives.

“ISO” means the California Independent System Operator Corporation.

“Interim Contract Order” means Decision 02-08-071 of the Commission, issued on August 22, 2002, as such Decision may be amended or supplemented from time to time by the Commission.

“Interim Contracts” mean the power purchase or exchange arrangements between DWR and various Suppliers entered into by DWR at the request of Utility and consistent with the Interim Contract Order, as listed in Schedule 2 attached hereto.

“Power Charges” shall have the meaning set forth in the Rate Agreement.

“Priority Long Term Power Contract” shall have the meaning set forth in the Rate Agreement.

“Rate Agreement” means the Rate Agreement between DWR and the Commission adopted by the Commission on February 21, 2002 in Decision 02-02-051.

“Remittance” means a payment by Utility to DWR or its Assign(s) in accordance with the Servicing Arrangement.

“Servicing Arrangement” means the Servicing Order as specified in Commission Decision 02-05-028, dated May 16, 2002.

“Supplier” means those certain third parties who are supplying power pursuant to the Contracts.

“Term” means term provided in Section 2.05 hereof.

“URG” means utility-retained generation, including without limitation Utility’s portfolio of generation resources and power purchase agreements prior to or after the Effective Date by Utility.

Section 1.02. Undefined Terms. Capitalized terms not otherwise defined in Section 1.01 herein shall have the meanings set forth in the Act or the Servicing Arrangement.

ARTICLE II
**OPERATIONAL ALLOCATION OF POWER PURCHASE AGREEMENTS;
MANAGEMENT OF THE CONTRACTS; ALLOCATED POWER; TERM**

Section 2.01. Operational Allocation and Management of Power Purchase Agreements. On behalf of DWR, as its limited agent, Utility will perform certain day-to-day scheduling and dispatch functions, billing and settlements and surplus energy sales and certain other tasks with respect to the Allocated Contracts and each Interim Contract, as more fully set forth in this Agreement.

As further provided in Contract Administration and Performance Test Monitoring Protocols set forth in Exhibit E, DWR will continue to monitor and audit the Supplier performance under the Contracts. Upon development of a mutually agreeable plan, Utility will monitor the performance of Suppliers, as further provided in Exhibit E, subject, however, to DWR's right but not the obligation to audit and monitor all functions contemplated to be performed by Utility, all as further provided in this Agreement.

Section 2.02. Standard of Contract Management.

(a) Utility agrees to perform the functions specified in this Agreement relating to the Allocated Contracts and Interim Contracts in a commercially reasonable manner, exercising Good Utility Practice, and in a fashion reasonably designed to serve the overall best interests of retail electric customers. Utility shall provide to DWR such information specifically provided in Exhibit F hereto to facilitate DWR's verification of Utility's compliance with this Section 2.02.

(b) To the extent requested by Utility, DWR shall provide evidence in Commission proceedings describing Utility's and DWR's performance, rights and obligations under this Agreement.

(c) DWR acknowledges the Commission's exclusive authority over whether the Utility has managed Allocated Power available under the Contracts in a just and reasonable manner and DWR and Utility each agrees that none of the provisions of this Agreement shall be interpreted to reduce, diminish or otherwise limit the scope of any Commission authority or to give DWR any authority over such matters.

(d) The Utility acknowledges DWR's separate and independent right to evaluate and enforce Utility's commercial performance under this Agreement.

(e) Utility agrees to provide any information not otherwise required herein that is reasonably necessary to allow DWR to exercise its rights in subsection (d) above, provided that all such information shall be used solely for the purposes of exercising such rights.

Section 2.03. Good Faith. Each Party hereby covenants that it shall perform its actions, obligations and duties in connection with this Agreement in good faith.

Section 2.04. DWR Power. During the term of this Agreement, the electric power and energy, including but not limited to capacity, and output, or any of them from the Contracts delivered to retail end-use customers in Utility's service area shall constitute DWR Power for all purposes of the Servicing Arrangement. Utility shall arrange for transmission service to accommodate surplus sales to the extent that transmission service is available and cost effective, all as further provided in Exhibit A.

Section 2.05. Term.

(a) The Term of this Agreement shall commence on the Effective Date and shall terminate on the earlier of (a) the termination of the Servicing Arrangement, or (b) the termination of this Agreement by DWR upon ninety days' written notice to Utility, or (c) upon consultation with the Commission, the termination of this Agreement by DWR upon reasonable written notice to Utility no shorter than 30 days, or (d) pursuant to Article VII hereof, the termination of this Agreement by a non-defaulting Party after an Event of Default. In addition, this Agreement will terminate as to each Contract that terminates in accordance with its terms. DWR agrees to notify Utility as to the termination of each Contract as provided in Section 5.01(e) hereof.

(b) If an event occurs which has the effect of materially altering and materially adversely impacting the economic position of the Parties or either of them under this Agreement, then the affected Party may, by written notice, require that this Agreement or other arrangements incidental to this Agreement be amended as necessary to preserve or restore the economic position under this Agreement held by the affected Party immediately prior to such event. Such notice shall describe the event and shall include reasonable particulars as to the manner and extent to which the economic position of the Party giving the notice has been adversely affected. The Parties shall use their reasonable efforts during a 180 day period following such notice to negotiate and effect such amendments following which the affected Party may, if such efforts are unsuccessful, terminate this Agreement immediately on notice.

ARTICLE III LIMITED AGENCY / NO ASSIGNMENT

Section 3.01. Limited Agency. Utility is hereby appointed as DWR's agent for the limited purposes set forth in this Agreement. Utility shall not be deemed to be acting, and shall not hold itself out, as agent for DWR for any purpose other than those described in this Agreement. Utility's duties and obligations shall be limited to those duties and obligations that are specified in this Agreement.

Section 3.02. No Assignment. DWR shall remain legally and financially responsible for performance under each of the Contracts and shall retain liability to the counterparty for any failure of Utility to perform the functions referred to in this

Agreement, on behalf of DWR as its limited agent, under such Contracts in accordance with the terms thereof. It is the intent of DWR and Utility that the provisions of this Agreement shall not constitute or result in an “assignment” of the Allocated Contracts in any respect.

ARTICLE IV LIMITED DUTIES OF UTILITY

Section 4.01. Limited Duties of Utility as to the Contracts. During the Term of this Agreement, Utility shall:

- (a) On behalf of DWR, as its limited agent, perform the day-to-day scheduling and dispatch functions, including day-ahead, hour-ahead and real time trading, scheduling transactions with all involved parties under the Allocated Contracts, perform billing and settlements functions and obtaining relevant information for these functions such as transmission availability and others, with respect to the Allocated Contracts set forth in Schedule 1 hereto, all as more specifically provided in the Operating Protocols attached hereto as Exhibit A;
- (b) On behalf of DWR, as its limited agent, enter into transactions for the purchase (or sale, as the case may be) of gas, gas transmission services, gas storage services and financial hedges, and perform the operational and administrative responsibilities for such purchases under gas tolling provisions under the Allocated Contracts, including the review of fuel plans and consideration of alternative fuel supply, all as more specifically provided in the Fuel Management Protocols attached hereto as Exhibit B;
- (c) On behalf of DWR, as its limited agent, perform all necessary billing and settlement functions under the Contracts and, prior to novation, the Interim Contracts, in accordance with the terms of the applicable Contracts. In addition, perform all necessary billing and settlement functions related to DWR Revenues and remit DWR Revenues to DWR, consistent with the Settlement Principles for Remittances and Surplus Revenues attached hereto as Exhibit C and the Servicing Arrangement;
- (d) Assume financial responsibility for the ISO charges listed on Exhibit D attached hereto;
- (e) On behalf of DWR, as its limited agent, upon development of a mutually agreeable plan, monitor the performance of Suppliers under the Allocated Contracts and undertake the administration of the Allocated Contracts, as more specifically provided in the Contract Administration and Performance Monitoring Protocols attached hereto as Exhibit E;

- (f) Provide to DWR the necessary information required by DWR as more specifically provided in the DWR Data Requirements From Utility attached hereto as Exhibit F to facilitate DWR's continued performance of financial obligations related to Allocated Contracts and to facilitate DWR's verification, audit and monitoring related to the Allocated Contracts and reporting requirements set forth in Applicable Laws or agreements;
- (g) At all times in performing its obligations under this Agreement (i) comply with the provisions of each of the Allocated Contracts, (ii) follow Good Utility Practice, and (iii) comply with all Applicable Laws and Applicable Commission Orders;
- (h) Appoint a primary and secondary contact person, as set forth in Schedule 3 hereto, to coordinate the responsibilities listed in this Section 4.01; and
- (i) On behalf of DWR, as its limited agent, make surplus energy sales as more specifically provided in this Agreement; and
- (j) Prior to novation of the Interim Contracts by Utility in accordance with the terms of each such Interim Contract, comply with the provisions listed in paragraphs (a) through (i) of this Section 4.01, in each case substituting the defined term Interim Contract(s) for the term Allocated Contract(s).

Provided, however, in the event that DWR fails to provide or provides inaccurate information which results in Utility's non-compliance with its obligations under this Agreement, the resulting non-compliance by Utility shall not constitute an Event of Default under Section 7.01 hereof.

Section 4.02. Dispatch or Sale of Allocated Power. Subject to any existing or new ISO tariff provisions that may affect the dispatch of such Contracts, Allocated Power from all Contracts shall be dispatched or sold, as the case may be, by Utility pursuant to the Operating Protocols attached hereto as Exhibit A.

Section 4.03. DWR Revenues. DWR Revenues shall be accounted and remitted to DWR consistent with the principles provided in the Settlement Principles for Remittances and Surplus Revenues attached hereto as Exhibit C and the provisions of the Servicing Arrangement. Unless otherwise specifically provided in this Agreement, Utility will not be required at any time to advance or pay any of its own funds in the fulfillment of its responsibilities under this Agreement.

Section 4.04. Ownership of Allocated Power. Notwithstanding any other provision herein, and in accordance with the Act and Section 80110 of the California Water Code, Utility and DWR agree that DWR shall retain title to all Allocated Power, including DWR Power. In accordance with the Act and Section 80104 of the California Water Code, upon the delivery of Allocated Power to Utility's customers, those

customers shall be deemed to have purchased that power from DWR, and payment for such sale shall be a direct obligation of such customer to DWR. In addition, Utility and DWR agree that DWR shall retain title to any surplus Allocated Power sold by Utility as limited agent to DWR as provided in this Agreement.

ARTICLE V DUTIES OF DWR

Section 5.01. Duties of DWR. Consistent with the Contract Allocation Order, during the Term of this Agreement, DWR shall:

- (a) Remain legally and financially responsible under each of the Contracts and cooperate with Utility in the transition from DWR to Utility the performance of the functions provided in this Agreement;
- (b) Assume legal and financial responsibilities and enter into or facilitate Utility's entering into transactions as DWR's limited agent, for the purchase (or sale, as the case may be) of gas, gas transmission services, gas storage services and financial hedges, and timely consent to or approve the Utility's performance of the operational and administrative responsibilities for such purchases under gas tolling provisions under the Allocated Contracts, including the review of fuel plans and consideration of alternative fuel supply, all as more specifically provided in the Fuel Management Protocols attached hereto as Exhibit B;
- (c) Pay invoices to the Suppliers and perform all necessary verification, audit and monitoring of the billing and settlement functions to be performed on DWR's behalf, as its limited agent, by Utility relating to the Contracts and, prior to novation, the Interim Contracts. In addition, perform all necessary verification, audit and monitoring of the billing and settlement functions to be performed on DWR's behalf, as its limited agent, by Utility related to DWR Revenues, consistent with the principles set forth in the Settlement Principles for Remittances and Surplus Revenues attached hereto as Exhibit C;
- (d) Until such time as a mutually agreed upon plan may be entered into with Utility, and no earlier than January 1, 2004, continue to monitor the performance of Suppliers and conduct certain contract administration duties under the Allocated Contracts, all as more specifically provided in the Contract Administration and Performance Monitoring Protocols attached hereto as Exhibit E. In addition, continue to perform all other administrative functions related to Contracts not explicitly provided in this Agreement to be performed by Utility on behalf of DWR, as its limited agent;

- (e) Upon the termination of any Contract, submit in writing to Utility appropriate Schedules and Attachments to Exhibit A amended to reflect the termination of any Contract. Such amended Schedules and Attachments shall become effective only upon the effective date of the termination of such Contract. Provided, however, rights or obligations of the Parties that arise or relate to Utility's performance of its duties under this Agreement in respect of any terminated Contract shall survive until the expiration of any such right or obligation;
- (f) In the event (1) Utility determines that it can perform its obligations under this Agreement by following more than one course of action, (2) Utility develops recommended protocols for implementing its obligations under this Agreement or (3) Utility is uncertain how to perform its obligations under the Agreement, Utility may, at its sole discretion, present the various options (including advantages or disadvantages), protocols, or proposed actions to DWR for directions, instructions or approvals and DWR will provide timely guidance to Utility. Utility action in compliance with instructions, directions or approvals provided by DWR, or, in the event DWR refuses to provide guidance, in compliance with Utility's recommendation, shall be deemed in compliance with the Agreement for all purposes under the Agreement and shall not be an Event of Default under Section 7.01 or subject to indemnification under Section 14.11; and
- (g) Appoint a primary and secondary contact person, as set forth in Schedule 3 hereto, to coordinate the responsibilities listed in this Section 5.01.

ARTICLE VI SPECIAL CONTRACT TERMS

Section 6.01. Special Contract Terms. In addition to the obligations set forth in this Agreement, Utility agrees to comply with the terms and provisions applicable to the Interim Contracts as set forth in Schedule 2 hereto.

ARTICLE VII EVENTS OF DEFAULT

Section 7.01. Events of Default. The following events shall constitute "Events of Default" under this Agreement:

- (a) any material failure by a Party to pay any amount due and payable under this Agreement that continues unremedied for five (5) Business Days after the earlier of the day the defaulting Party receives written notice thereof from the non-defaulting Party; or

(b) any material failure by Utility to schedule and dispatch Contracts, consistent with the principles set forth in Exhibit A; or

(c) any failure (except as provided in (a) or (b)) by a Party to duly observe or perform in any material respect any other covenant or agreement of such Party set forth in this Agreement, which failure continues unremedied for a period of 15 calendar days after written notice of such failure has been given to such Party by the non-defaulting Party; or

(d) any material representation or warranty made by a Party shall prove to be false, misleading or incorrect in any material respect as of the date made; or

(e) an Event of Default (as defined under the Servicing Arrangement) shall have occurred and is continuing under the Servicing Arrangement.

Section 7.02. Consequences of Utility Event of Default. Upon any Event of Default by Utility, DWR may, in addition to exercising any other remedies available under this Agreement or under Applicable Law, (i) terminate this Agreement in whole or in part; and (ii) apply in an appropriate forum for sequestration and payment to DWR or its Assign(s) of DWR Revenues or for specific performance of the functions related to the Contracts to be performed by Utility on behalf of DWR, as its limited agent, as provided in this Agreement.

Section 7.03. Consequences of DWR Event of Default. Upon an Event of Default by DWR, Utility may, in addition to exercising any other remedies available under this Agreement or under Applicable Law, terminate this Agreement in whole or in part so long as Utility (i) provides a notice of such Event of Default and (ii) provides for 180 days to cure such default. Only if the Event of Default has not been cured in 180 days may Utility may terminate this Agreement immediately upon written notice to DWR.

Section 7.04. Remedies. Subject to Article XIII of this Agreement, upon any Event of Default, the non-defaulting Party may exercise any other legal or equitable right or remedy that may be available to it under applicable law or under this Agreement, including, but not limited to, termination of this Agreement.

Section 7.05. Remedies Cumulative. Except as otherwise provided in this Agreement, all rights of termination, cancellation, or other remedies in this Agreement are cumulative. Use of any remedy shall not preclude any other remedy available under this Agreement.

Section 7.06. Waivers. None of the provisions of this Agreement shall be considered waived by either Party unless the Party against whom such waiver is claimed gives such waiver in writing. The failure of either Party to insist in any one or more instances upon strict performance of any of the provisions of this Agreement or to take advantage of any of its rights hereunder shall not be construed as a waiver of any such provisions or the relinquishment of any such rights for the future, but the same shall

continue and remain in full force and effect. Waiver by either Party of any default by the other Party shall not be deemed a waiver of any other default.

ARTICLE VIII PAYMENT OF FEES AND CHARGES

Section 8.01. Utility Fees and Charges. At the election of Utility, DWR agrees that it will pay to Utility a fee in order to cover Utility's (1) set-up costs associated with establishing the procedures, systems, and mechanisms necessary to perform services under the Agreement; (2) recurring costs incurred by Utility in order to provide on-going services under the Agreement and (3) additional costs incurred by Utility as a result of changes in the Agreement or other unanticipated events or circumstances. Such costs to be paid by DWR shall be based on the annual cost reasonably determined by Utility and shall be paid by DWR on a calendar month basis, to be mutually developed by the Parties. DWR's obligation to pay such costs shall be payable exclusively from the Electric Power Fund, consistent with the payment priority for such costs established in the trust indenture relating to the Bonds.

Alternatively, at the election of Utility, Utility shall enter the cost of such fees and charges in its Purchased Electric Commodity Account, or its successor or another account designated by the Commission on a current basis, for recovery in retail rates subject to subsequent Commission review.

Utility shall notify DWR of its election under this section on January 15 of each year for the fiscal year commencing on July 1 of the next year. To the extent Utility elects to recover its costs in retail rates, Utility will provide annual notice to DWR of its costs of providing service under this Agreement. If Utility notifies DWR before January 1, 2003 of its election under this Section, DWR agrees to seek appropriate adjustments in its 2003 revenue requirement previously submitted to the Commission.

ARTICLE IX REPRESENTATIONS AND WARRANTIES

Section 9.01. Representations and Warranties.

(a) Each person executing this Agreement for the respective Parties expressly represents and warrants that he or she has authority to bind the Party on whose behalf he or she has executed this Agreement.

(b) Each Party represents and warrants that it has the full power and authority to execute and deliver this Agreement and to perform its terms, that execution, delivery and performance of this Agreement have been duly authorized by all necessary corporate or other action by such Party, and that this Agreement constitutes such Party's legal, valid and binding obligation, enforceable against such Party in accordance with its terms.

(c) DWR represents and warrants that all necessary and appropriate notices, inducements, undertakings, approvals, and consents have been obtained from each

Supplier to the Contract allocated to Utility in order for Utility to undertake its duties set forth in this Agreement in a timely and appropriate fashion.

ARTICLE X LIMITATIONS ON LIABILITY

Section 10.01. Consequential Damages. In no event will either Party be liable to the other Party for any indirect, special, exemplary, incidental, punitive, or consequential damages under any theory. Nothing in this Section 10.01 shall limit either Party's rights as provided in Article VII above.

Section 10.02. Limited Obligations of DWR. Any amounts payable by DWR under this Agreement shall be payable solely from moneys on deposit in the Department of Water Resources Electric Power Fund established pursuant to Section 80200 of the California Water Code (the "Fund").

Section 10.03. Sources of Payment; No Debt of State. DWR's obligation to make payments hereunder shall be limited solely to the Fund and shall be payable as an operating expense of the Fund solely from Power Charges subject and subordinate to each Priority Long Term Power Contract in accordance with the priorities and limitations established with respect to the Fund's operating expenses in any indenture providing for the issuance of Bonds and in the Rate Agreement and in the Priority Long Term Contracts. Any liability of DWR arising in connection with this Agreement or any claim based thereon or with respect thereto, including, but not limited to, any payment arising as the result of any breach or Event of Default under this Agreement, and any other payment obligation or liability of or judgment against DWR hereunder, shall be satisfied solely from the Fund. NEITHER THE FULL FAITH AND CREDIT NOR THE TAXING POWER OF THE STATE OF CALIFORNIA ARE OR MAY BE PLEDGED FOR ANY PAYMENT UNDER THIS AGREEMENT. Revenues and assets of the State Water Resources Development System, and Bond Charges under the Rate Agreement, shall not be liable for or available to make any payments or satisfy any obligation arising under this Agreement. If moneys on deposit in the Fund are insufficient to pay all amounts payable by DWR under this Agreement, or if DWR has reason to believe such funds may become insufficient to pay all amounts payable by DWR under this Agreement, DWR shall request and diligently pursue an increase to its revenue requirements as permitted under the Act from the appropriate Governmental Authority as soon as practicable. To the extent DWR's obligations are "administrative costs," they will require annual appropriation by the legislature.

Section 10.04. Cap on Liability. In no event will Utility be liable to DWR for damages under this Agreement, including indemnification obligations, whether in contract, warranty, tort (including negligence), strict liability or otherwise (referred to as "Damages" for purposes of this Section), in an amount in excess of: 1) on an annual calendar year basis, \$5 million plus ten percent of Damages in excess of \$5 million and 2) for the entire term of this Agreement, \$50 million in total payments of Damages to DWR. For example, if Damages for an event are \$100 million, Utility's total liability for this event would be \$14.5 million (\$5 million plus 10% of \$95 million) and that would be

the full extent of Utility's liability for such Damages. All Damages associated with an event will apply only to the annual limit in the first year in which Damages for that event were assessed. For example, if Damages for an event were paid as follows: \$15 million in year 1 and \$10 million in year 2, the Utility would pay DWR \$7 million (\$5 million plus 10% of \$10 million for year 1 and 10% of \$10 million for year 2). In this example, the \$1 million paid to DWR in year 2 (10% of \$10 million) does not count against the year 2 \$5 million calendar year threshold. DWR hereby releases Utility from any liability for Damages in excess of the limitations on liability set forth in this Section 10.04, provided, however, that this limitation on Utility liability shall not apply to the extent the liability is a result of Utility's gross negligence or willful misconduct.

ARTICLE XI CONFIDENTIALITY

Section 11.01. Proprietary Information.

(a) Nothing in this Agreement shall affect Utility's obligations to observe any Applicable Law prohibiting the disclosure of Confidential Information regarding its customers.

(b) Nothing in this Agreement, and in particular nothing in Sections 11.01(e)(x) through 11.01(e)(z) of this Agreement, shall affect the rights of the Commission to obtain from Utility, pursuant to Applicable Law, information requested by the Commission, including Confidential Information provided by DWR to Utility. Applicable Law, and not this Agreement, will govern what information the Commission may disclose to third parties, subject to any confidentiality agreement between DWR and the Commission.

(c) The Parties acknowledge that each Party may acquire information and material that is the other Party's confidential, proprietary or trade secret information. As used herein, "Confidential Information" means any and all technical, commercial, financial and customer information disclosed by one Party to the other (or obtained from one Party's inspection of the other Party's records or documents), including any patents, patent applications, copyrights, trade secrets and proprietary information, techniques, sketches, drawings, maps, reports, specifications, designs, records, data, models, inventions, know-how, processes, apparatus, equipment, algorithms, software programs, software source documents, object code, source code, and information related to the current, future and proposed products and services of each of the Parties, and includes, without limitation, the Parties' respective information concerning research, experimental work, development, design details and specifications, engineering, financial information, procurement requirements, purchasing, manufacturing, business forecasts, sales and merchandising, and marketing plans and information. In all cases, Confidential Information includes proprietary or confidential information of any third party disclosing such information to either Party in the course of such third party's business or relationship with such Party. Utility's Confidential Information also includes any and all lists of customers, and any and all information about customers, both individually and aggregated, including but not limited to customers' names, street addresses of customer

residences and/or facilities, email addresses, identification numbers, Utility account numbers and passwords, payment histories, energy usage, rate schedule history, allocation of energy uses among customer residences and/or facilities, and usage of DWR Power. All Confidential Information disclosed by the disclosing Party (“Discloser”) will be considered Confidential Information by the receiving Party (“Recipient”) if identified as confidential and received from Discloser.

(d) Each Party agrees to take all steps reasonably necessary to hold in trust and confidence the other Party’s Confidential Information. Without limiting the generality of the immediately preceding sentence, each Party agrees (i) to hold the other Party’s Confidential Information in strict confidence, not to disclose it to third parties or to use it in any way, commercially or otherwise, other than as permitted under this Agreement; and (ii) to limit the disclosure of the Confidential Information to those of its employees, agents or directly related subcontractors with a need to know who have been advised of the confidential nature thereof and who have acknowledged their express obligation to maintain such confidentiality. DWR shall not disclose Confidential Information to employees, agents or subcontractors that are in any respect responsible for power marketing or trading activities associated with the State Water Resources Development System.

(e) The foregoing two paragraphs will not apply to any item of Confidential Information if: (i) it has been published or is otherwise readily available to the public other than by a breach of this Agreement; (ii) it has been rightfully received by Recipient from a third party without breach of confidentiality obligations of such third party and outside the context of the provision of services under this Agreement; (iii) it has been independently developed by Recipient personnel having no access to the Confidential Information; (iv) it was known to Recipient prior to its first receipt from Discloser, or (v) it has been summarized, processed and incorporated for incorporation into reports, discussions, statements or any other further work product. In addition, Recipient may disclose Confidential Information if and to the extent required by law or a Governmental Authority, provided that (x) Recipient shall give Discloser a reasonable opportunity to review and object to the disclosure of such Confidential Information, (y) Discloser may seek a protective order or confidential treatment of such Confidential Information, and (z) Recipient shall make commercially reasonable efforts to cooperate with Discloser in seeking such protective order or confidential treatment. Discloser shall pay Recipient its reasonable costs of cooperating.

Section 11.02. No License. Nothing contained in this Agreement shall be construed as granting to a Party a license, either express or implied, under any patent, copyright, trademark, service mark, trade dress or other intellectual property right, or to any Confidential Information now or hereafter owned, obtained, controlled by, or which is or may be licensable by, the other Party.

Section 11.03. Survival of Provisions. The provisions of this Article XI shall survive the termination of this Agreement.

ARTICLE XII RECORDS AND AUDIT RIGHTS

Section 12.01. Records. Utility shall maintain accurate records and accounts relating to the Contracts in sufficient detail to permit DWR to audit and monitor the functions to be performed by Utility on behalf of DWR, as its limited agent, under this Agreement. In addition, Utility shall maintain accurate records and accounts relating to DWR Revenues to be remitted by Utility to DWR, consistent with the Settlement Principles for Remittances and Surplus Revenues set forth in Exhibit C hereto. Utility shall provide to DWR and its Assign(s) access to such records. Access shall be afforded without charge, upon reasonable request made pursuant to Section 12.02. Access shall be afforded only during Business Hours and in such a manner so as not to interfere unreasonably with Utility's normal operations. Utility shall not treat DWR Revenues as income or assets of Utility or any affiliate for any tax, financial reporting or regulatory purposes, and the financial books or records of Utility and affiliates shall be maintained in a manner consistent with the absolute ownership of DWR Revenues by DWR and Utility's holding of DWR Revenues in trust for DWR (whether or not held together with other monies).

Section 12.02. Audit Rights.

(a) Upon 30 calendar days' prior written notice, DWR may request an audit, conducted by DWR or its agents (at DWR's expense), of Utility's records and procedures, which shall be limited to records and procedures containing information bearing upon Utility's performance of its obligations under this Agreement. The audit shall be conducted during Business Hours without interference with Utility's normal operations, and in compliance with Utility's security procedures.

(b) As provided in the Act, the State of California Bureau of State Audits (the "Bureau") shall conduct a financial and performance audit of DWR's implementation of Division 27 (commencing with Section 80000) of the California Water Code, and the Bureau shall issue a final report on or before March 31, 2003. In addition, as provided in Section 8546.7 of the California Government Code, Utility agrees that, pursuant to this Section 12.02, DWR or the State of California Department of General Services, the Bureau, or their designated representative ("DWR's Agent") shall have the right to review and to copy (at DWR's expense) any non-confidential records and supporting documentation pertaining to the performance of this Agreement and to conduct an on-site review of any Confidential Information pursuant to Section 12.03 hereof. Utility agrees to maintain such records for such possible audit for three years after final Remittance to DWR. Utility agrees to allow such auditor(s) access to such records during Business Hours and to allow interviews of any employees who might reasonably have information related to such records. Further, Utility agrees to include a similar right for DWR or DWR's Agent to audit records and interview staff in any contract between Utility and a subcontractor directly related to performance of this Agreement.

Section 12.03. Confidentiality. Materials reviewed by either Party or its agents in the course of an audit may contain Confidential Information subject to Article XI above. The use of all materials provided to DWR or Utility or their agents, as the case may be pursuant to this Article XII, shall comply with the provisions in Article XI and shall be limited to use in conjunction with the conduct of the audit and preparation of a report for appropriate distribution of the results of the audit consistent with Applicable Law.

Section 12.04. Annual Certifications. At least annually, and in no event later than the tenth Business Day after the end of the calendar year, Utility shall deliver to DWR a certificate of an authorized representative certifying that to the best of such representative's knowledge, after a review of Utility's performance under this Agreement, Utility has fulfilled its obligations under this Agreement in all material respects and is in compliance herewith in all material respects.

Section 12.05. Additional Applicable Laws. Each Party shall make an effort to promptly notify the other Party in writing to the extent such Party becomes aware of any new Applicable Laws or changes (or proposed changes) in Applicable Tariffs hereafter enacted, adopted or promulgated that may have a material adverse effect on either Party's ability to perform its duties under this Agreement. A Party's failure to so notify the other Party pursuant to this Section 12.05 will not constitute a material breach of this Agreement, and will not give rise to any right to terminate this Agreement or cause either Party to incur any liability to the other Party or any third party.

Section 12.06. Other Information. Upon the reasonable request of DWR or its Assign(s), Utility shall provide to DWR or its Assign(s) any public financial information in respect of Utility applicable to services provided by Utility under this Agreement, to the extent such information is reasonably available to Utility, which (i) is reasonably necessary and permitted by Applicable Law to monitor the performance by Utility hereunder, or (ii) otherwise relates to the exercise of DWR's rights or the discharge of DWR's duties under this Agreement or any Applicable Law. In particular, but without limiting the foregoing, Utility shall provide to DWR any such information that is necessary or useful to calculate DWR's revenue requirements (as described in Sections 80110 and 80134 of the California Water Code).

Section 12.07. Data and Information Retention. All data and information associated with the provision and receipt of services pursuant to this Agreement shall be maintained for the greater of (a) the retention time required by Applicable Law or Applicable Tariffs for maintaining such information, or (b) three (3) years.

ARTICLE XIII DISPUTE RESOLUTION

Section 13.01. Dispute Resolution. Should any dispute arise between the Parties or should any dispute between the Parties arise from the exercise of either Party's audit rights contained in Section 12.02 hereof, the Parties shall remit any undisputed amounts and agree to enter into good faith negotiations as soon as practicable to resolve such disputes within (10) Business Days so as to resolve such disputes, as appropriate, within

the timeframes provided under this Agreement, or as soon as possible thereafter. For any disputed Remittances, if such resolution cannot be made before the remittance date, Utility shall remit the undisputed portion to DWR. In addition, the disputed portion of the Remittances shall be deposited into an escrow account held by a qualified, independent escrow holder. Upon resolution of such disputes, the Party that escrowed the disputed amount shall reimburse the other Party from the escrow account as necessary.

Section 13.02. ISO Settlements Disputes. Utility shall review, validate and verify all ISO charges/credits contained on all ISO settlement statements, including any charges/credits resulting from the functions related to the Contracts to be performed by Utility as provided in this Agreement. Utility shall inform DWR of any discrepancies and shall dispute any such discrepancies with the ISO in accordance with the ISO's tariff and protocols. Except as provided in Section 13.03, if any ISO charge type settlement amount appearing on a Preliminary or Final Settlement Statement (as defined in the ISO tariff) resulting or relating to the Utility's performance of functions related to the Contracts under this Agreement is in dispute, it shall be the responsibility of Utility, on behalf of DWR, as its limited agent, to seek resolution of said dispute through the ISO dispute resolution process as provided in the ISO's tariff.

For disputes affecting Utility's Remittances to DWR, including disputes on ISO charges to non-DWR parties that would affect Remittances to DWR, Utility shall provide to DWR: a) notification of submission of the dispute through the ISO dispute resolution process, identifying, among other items, the dispute type, quantity, price and allocation; b) a copy of the submitted dispute and all supporting data; and c) a copy of all ensuing documentation resulting from the ongoing dispute resolution process. Utility shall track and validate all disputed ISO charges involving any financial responsibility of DWR.

Section 13.03. Supplier Invoice Disputes. DWR shall continue to be responsible for all dispute resolution relating to Supplier invoices. In addition, except as specifically provided in Exhibit E of this Agreement, all other contract administration functions shall remain DWR's responsibility.

Section 13.04. Good-Faith Negotiations. Should any dispute arise between the Parties relating to this Agreement, the Parties shall undertake good-faith negotiations to resolve such dispute. If the Parties are unable to resolve such dispute through good-faith negotiations, either Party may submit a detailed written summary of the dispute to the other Party. Upon such written presentation, each Party shall designate an executive with authority to resolve the matter in dispute. If the Parties are unable to resolve such dispute within 30 days from the date that a detailed summary of such dispute is presented in writing to the other Party, then the Parties shall submit to binding arbitration under mutually acceptable terms and conditions.

Section 13.05. Costs. Each Party shall bear its own respective costs and attorney fees in connection with respect to any dispute resolution process undertaken by it pursuant to this Article. Provided, however, DWR shall reimburse Utility all reasonably incurred costs, including, but not limited to, in-house and retained attorneys, consultants, witnesses, and arbitration costs, arising from or pertaining to all disputes relating to ISO

charges/credits contained on all ISO settlement statements resulting from the operational, dispatch and administrative functions related to the Contracts performed by Utility on behalf of DWR, as its limited agent, pursuant to the standards set forth in Section 2.02 herein and consistent with the provisions of the ISO tariff, as may be amended from time to time, including disputes on ISO charges to non-DWR parties that would affect Remittances to DWR. These costs shall be recorded and invoiced in the manner set forth in Section 8.01 hereof; provided, if such costs are reimbursed by DWR to Utility, then such costs shall not be included by Utility for recovery under the process contemplated under Section 8.01 hereof.

ARTICLE XIV MISCELLANEOUS

Section 14.01. Assignment.

(a) Except as provided in paragraphs (b), (c), (d) and (e) below, neither Party shall assign or otherwise dispose of this Agreement, its right, title or interest herein or any part hereof to any entity, without the prior written consent of the other Party. No assignment of this Agreement shall relieve the assigning Party of any of its obligations under this Agreement until such obligations have been assumed by the assignee. When duly assigned in accordance with this Section 14.01(a) and when accepted by the assignee, this Agreement shall be binding upon and shall inure to the benefit of the assignee. Any assignment in violation of this Section 14.01(a) shall be void.

(b) Utility acknowledges and agrees that DWR may assign or pledge its rights to receive performance hereunder to a trustee or another party ("Assign(s)") in order to secure DWR's obligations under its bonds (as that term is defined in the Act), and any such Assign shall be a third party beneficiary of this Agreement; provided, however, that this authority to assign or pledge rights to receive performance hereunder shall in no event extend to any person or entity that sells power or other goods or services to DWR.

(c) Any person (i) into which Utility may be merged or consolidated, (ii) which may result from any merger or consolidation to which Utility shall be a party or (iii) which may succeed to the properties and assets of Utility substantially as a whole, which person in any of the foregoing cases executes an agreement of assumption to perform every obligation of Utility hereunder, shall be the successor to Utility under this Agreement without further act on the part of any of the Parties to this Agreement; provided, however, that Utility shall have delivered to DWR and its Assign(s) an opinion of counsel reasonably acceptable to DWR stating that such consolidation, merger or succession and such agreement of assumption complies with this Section 13.01(c) and that all of Utility's obligations hereunder have been validly assumed and are binding on any such successor or assign.

(d) Notwithstanding anything to the contrary herein, DWR's rights and obligations hereunder shall be transferred, without any action or consent of either Party hereto, to any entity created by the State legislature which is required under Applicable

Law to assume the rights and obligations of DWR under Division 27 of the California Water Code.

(e) Notwithstanding anything to the contrary herein, Utility's rights and obligations under this Agreement may be assigned to the reorganized debtor under a plan or reorganization approved by the Bankruptcy Court for Utility without any action or consent of either Party hereto.

Section 14.02. Force Majeure. Neither Party shall be liable for any delay or failure in performance of any part of this Agreement (including the obligation to remit money at the times specified herein) from any cause beyond its reasonable control, including but not limited to, unusually severe weather, flood, fire, lightning, epidemic, quarantine restriction, war, sabotage, act of a public enemy, earthquake, insurrection, riot, civil disturbance, strike, restraint by court order or Government Authority, or any combination of these causes, which by the exercise of due diligence and foresight such Party could not reasonably have been expected to avoid and which by the exercise of due diligence is unable to overcome.

Section 14.03. Severability. In the event that any one or more of the provisions of this Agreement shall for any reason be held to be unenforceable in any respect under applicable law, such unenforceability shall not affect any other provision of this Agreement, but this Agreement shall be construed as if such unenforceable provision or provisions had never been contained herein.

Section 14.04. Survival of Payment Obligations. Upon termination of this Agreement, each Party shall remain liable to the other Party for all amounts owing under this Agreement. Utility shall continue to collect and remit, pursuant to the terms of the Servicing Arrangement and the principles provided in the Settlement Principles for Remittances and Surplus Revenues provided in Exhibit C hereto and any DWR Charges billed to customers or any DWR Surplus Energy Sales Revenues attributable to sales entered into before the effective date of termination of the Servicing Arrangement.

Section 14.05. Third-Party Beneficiaries. The provisions of this Agreement are exclusively for the benefit of the Parties and any permitted assignee of either Party and there are no other third party beneficiaries under this Agreement.

Section 14.06. Governing Law. This Agreement shall be interpreted, governed and construed under the laws of the State of California without regard to choice of law provisions.

Section 14.07. Multiple Counterparts. This Agreement may be executed in multiple counterparts, each of which shall be an original.

Section 14.08. Section Headings. Section and paragraph headings appearing in this Agreement are inserted for convenience only and shall not be construed as interpretations of text.

Section 14.09. Amendments. No amendment, modification, or supplement to this Agreement shall be effective unless it is in writing and signed by the authorized representatives of both Parties and approved as required, and by reference incorporates this Agreement and identifies the specific portions that are amended, modified, or supplemented or indicates that the material is new. No oral understanding or agreement not incorporated in this Agreement is binding on either of the Parties.

Section 14.10. Amendment Upon Changed Circumstances. The Parties acknowledge that compliance with any Commission decision, legislative action or other governmental action (whether issued before or after the Effective Date of this Agreement) affecting the operation of this Agreement, including but not limited to (i) dissolution of the ISO, (ii) changes in the ISO market structure, (iii) a decision regarding direct access currently pending before the Commission, (iv) the establishment of other Governmental Programs, or (v) a modification to the Contract Allocation Order may require that amendment(s) be made to this Agreement. The Parties therefore agree that if either Party reasonably determines that such a decision or action would materially affect the services to be provided hereunder or the reasonable costs thereof, then upon the issuance of such decision or the approval of such action (unless and until it is stayed), the Parties will negotiate the amendment(s) to this Agreement that is (or are) appropriate in order to effectuate the required changes in services to be provided or the reimbursement thereof. If the Parties are unable to reach agreement on such amendments within 60 days after the issuance of such decision or approval of such action, either Party may, in the exercise of its sole discretion, submit the disagreement to binding arbitration under mutually acceptable terms and conditions for proposed resolution. Nothing herein shall preclude either Party from challenging the decision or action which such Party deems may adversely affect its interests in any appropriate forum of the Party's choosing.

The Parties agree that, if the rating agencies request changes to this Agreement which the Parties reasonably determine are necessary and appropriate, the Parties will negotiate in good faith, but will be under no obligation to reach agreement, to amend this Agreement to accommodate the rating agency requests and will cooperate in obtaining any required approvals of the Commission or other entities for such amendments.

Section 14.11 Indemnification.

(a) Indemnification of DWR. Utility (the "Indemnitor") shall at all times protect, indemnify, defend and hold harmless DWR, and its elected officials, appointed officers, employees, representatives, agents and contractors (each, an "Indemnified Party" or an "Indemnitee") from and against (and pay the full amount of) any and all claims (whether in tort, contract or otherwise), demands, expenses (including, without limitation, in-house

and retained attorneys' fees) and liabilities for losses, damage, injury and liability of every kind and nature and however caused, and taxes (of any kind and by whomsoever imposed), to third parties arising from or in connection with (or alleged to arise from in connection with): (1) any failure by Utility to perform its material obligations under this Agreement; (2) any material representation or warranty made by Utility shall prove to be false, misleading or incorrect in any material respect as of the date made; (3) the gross negligence or willful misconduct of Utility or any of its officers, directors, employees, agents, representatives, subcontractors or assignees in connection with this Agreement; and (4) any violation of or failure by Utility or Indemnitor to comply with any Applicable Commission Orders or Applicable Law; provided, however, that the foregoing indemnifications and protections shall not extend to any losses arising from gross negligence or willful misconduct of any Indemnified Party.

(b) Obligation of Utility. Consistent with the Contract Allocation Order, Utility shall not, in acting as limited agent of DWR hereunder be required to perform any obligations of any Supplier under any Allocated Contract or to make any payments on behalf of such Supplier or as the result of the failure of such Supplier to perform under any Allocated Contract.

(c) Indemnification of Utility. To the extent permitted by law, DWR ("Indemnitor") shall at all times protect, indemnify, defend and hold harmless Utility, and its officers, employees, representatives, agents and contractors (each, an "Indemnified Party" or "Indemnitee"), from and against (and pay the full amount of) any and all claims (whether in tort, contract or otherwise), demands, expenses (including, without limitation, in-house and retained attorneys' fees) and liabilities for losses, damage, injury and liability of every kind and nature and however caused, and taxes (of any kind and by whomsoever imposed), to third parties arising from or in connection with (or alleged to arise from on in connection with): (1) any failure by DWR to perform its material obligations under this Agreement or any Allocated Contract and prior to novation, any Interim Contract; (2) any material representation or warranty made by DWR shall prove to be false, misleading or incorrect in any material respect as of the date made; (3) the gross negligence or willful misconduct of the DWR or any of its officers, directors or employees, agents, representatives, subcontractors or assignees in connection with this Agreement; (4) any action claiming Utility failed to perform any Supplier's obligations under an Allocated Contract; and (5) any violation of or failure by DWR or Indemnitor to comply with any Applicable Law; and provided, however, that the foregoing indemnifications and protections shall not extend to any losses arising from the gross negligence or willful misconduct of any Indemnified Party.

(d) Indemnification Procedures. Indemnitee shall promptly give notice to Indemnitor of any claim or action to which it seeks indemnification from Indemnitor. Indemnitor shall defend any such claim or action brought against it, and may also defend such claim or action on behalf of the Indemnitee (with counsel reasonably satisfactory to Indemnitor) unless there is any actual or potential conflict between Indemnitor and Indemnitee with respect to such claim or action. If there is any actual or potential conflict between Indemnitor and Indemnitee with respect to such claim or action, Indemnitee shall have the opportunity to assume (at Indemnitor's expense) defense of any

claim or action brought against Indemnitee by a third party; however, failure by Indemnitee to request defense of such claim or action by the Indemnitor shall not affect Indemnitee's right to indemnity under this Section 14.11. In any action or claim involving Indemnitee, Indemnitor shall not settle or compromise any claim without the prior written consent of Indemnitee.

Section 14.12. Notices and Demands. (a) Except as otherwise provided under this Agreement, all notices, demands, or requests pertaining to this Agreement shall be in writing and shall be deemed to have been given (i) on the date delivered in person, (ii) on the date when sent by facsimile (with receipt confirmed by telephone by the intended recipient or his or her authorized representative) or electronic transmission (with receipt confirmed telephonically or electronically by the intended recipient or his or her authorized representative) or by special messenger, or (iii) 72 hours following delivery to a United States post office when sent by certified or registered United States mail postage prepaid, and addressed as set forth below:

Utility: Pacific Gas and Electric Company
245 Market Street, room 1267
San Francisco, CA 94105-1814

Attn: Roy Kuga
Lead Director Gas and Electric Supply
Telephone: (415) 973-3806
Facsimile: (415) 973-0585
Email: rmk4@pge.com

DWR: State of California
The Resources Agency
Department of Water Resources
California Energy Resources Scheduling Division
3310 El Camino Avenue, Suite 120
Sacramento, California 95821

Attn: Peter S. Garris
Deputy Director
Telephone: (916) 574-2733
Facsimile: (916) 574-0301
Email: pgarris@water.ca.gov

(b) Each Party shall be entitled to specify as its proper address any other address in the United States, or specify any change to the above information, upon written notice to the other Party complying with this Section 14.12.

(c) Each Party shall designate on Attachment A the person(s) to be contacted with respect to specific operational matters. Each Party shall be entitled to specify any

change to such person(s) upon written notice to the other Party complying with this Section 14.12.

Section 14.13. Approval. This Agreement shall be effective upon the execution by both Parties and approval of such executed agreement by the Commission; provided however such effectiveness shall not be earlier than January 1, 2003. Except as expressly provided otherwise herein, neither Party may commence performance hereunder until such date. Any delay in the commencement of performance hereunder as a consequence of waiting for such approval(s) shall not be a breach or default under this Agreement.

Section 14.14. Government Code and Public Contract Code Inapplicable. DWR has determined, pursuant to Section 80014(b) of the California Water Code, that application of certain provisions of the Government Code and Public Contract Code applicable to State contracts, including but not limited to advertising and competitive bidding requirements and prompt payment requirements, would be detrimental to accomplishing the purposes of Division 27 (commencing with Section 80000) of the California Water Code and that such provisions and requirements are therefore not applicable to or incorporated in this Agreement.

Section 14.15. Annual Review. The provisions of the Exhibits are subject to annual review by DWR and Utility to ensure their relevance and usefulness. In the event that the Parties mutually agree that certain provisions of the Exhibits should be amended or supplemented, an amendment to the Exhibit should be executed and Utility shall submit to the Commission for approval.

Section 14.16 Other Operating Agreement. It is DWR's intent to have a consistent operating agreement with all three investor-owned utilities (IOUs). Should DWR reach an operating agreement with another IOU relating to the subject matter of this Agreement that in Utility's judgment is more favorable on the whole than this Agreement, Utility shall have the right to receive the same terms and conditions as such other IOU. This provision specifically does not allow Utility to select particular portions or provisions of such other IOUs' operating agreement. In addition, if Utility elects to be subject to such other IOU's operating agreement's terms and conditions, Utility shall be subject to such other IOU's operating agreement with only such modifications agreed to by DWR as necessary to address operating differences between that other IOU and Utility. Utility shall exercise the foregoing right within 60 days following Commission approval of such other operating agreement.

IN WITNESS WHEREOF, the Parties have executed this Agreement on the date or dates indicated below, to be effective as of the Effective Date.

**CALIFORNIA STATE DEPARTMENT
OF WATER RESOURCES**, acting solely under
the authority and powers granted by AB1X,
codified as Sections 80000 through 80270 of the
Water Code, and not under its powers and
responsibilities with respect to the State Water
Resources Development System

**PACIFIC GAS AND ELECTRIC
COMPANY**, a California corporation

By: _____

Name: _____

Title: _____

Date: _____

By: _____

Name: _____

Title: _____

Date: _____

Schedule 1

ALLOCATED CONTRACTS**DWR Contract Allocation for PG&E**

Long-Term Contract	Contract Category
Allegheny 2 150 MW 6x16 in NP-15 for 2003	Must-Take
Calpine 1 Product 1	Must-Take
Calpine 2 Product 1	Must-Take
Capitol Power	Must-Take
Clearwood	Must-Take
Constellation - Product 2 400 MW 7x24 May to Oct. '03	Must-Take
Coral	Must-Take
El Paso 50 MW 6x16 in NP-15	Must-Take
Intercom	Must-Take
Santa Cruz	Must-Take
Soledad	Must-Take
Calpine 1 - Product 2	Dispatchable
Calpine 2 - Product 3 & 4	Dispatchable
Calpine 3	Dispatchable
Calpine SJ	Dispatchable
Calpeak (3 contracts) New Site, Panoche, and Vaca-Dixon	Dispatchable
GWF	Dispatchable
Pacificorp PacifiCorp	Dispatchable
Wellhead (3 contracts) Fresno, Gates, and Panoche	Dispatchable

Schedule 2

INTERIM CONTRACTS

[To be updated upon Commission Approval]

Counter-Party for the Interim Contract	Contract Category

Schedule 3

REPRESENTATIVES AND CONTACTS

[to be provided by PG&E]